

## REFORMING GOVERNMENT REGULATION OF BUSINESS

by Murray L. Weidenbaum

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The future of the private enterprise system in the United States is going to be determined by the outcome of the current debate that is now heating up over government regulation and deregulation. Frankly, do not get your hopes up too high. The vast regulatory apparatus that has developed in Washington over many years is not suddenly going to be dismantled.

But this new national debate does give us the opportunity for the first time to bring to everyone's attention some basic facts, facts known to every business executive, but not to the public. The single fact that I find most important — in getting the attention of the public — is that it is the *consumer* who ultimately bears the burden of overregulation of business. Most of the time, the proponents of new *government controls* focus all of their attention on the potential benefits — and often those benefits can be real and substantial. But they overlook the large costs which are so often involved, costs to both the taxpayer and the consumer — and that, I find, is the Achilles heel of the regulators. Let me give you some perspective.

### The New Wave of Regulation

A massive expansion of government controls over private industry is underway in the United States. Government officials are exercising an ever larger role in what traditionally has been internal business decision-making. Just as an example, I took a recent issue of the *Wall Street Journal*, and cut out all of the articles that dealt with one or more aspects of

government-business relations. There wasn't much left except the ads.

It is not just a matter of more of the same. This new wave of government regulation is not merely an intensification of existing activities; in good measure, it is a new departure.

The traditional theory of government regulation of business, which is still in general use and has dominated professional and public thinking on the subject, is based on the model of the Interstate Commerce Commission. Under this approach, a federal commission is established to regulate a specific industry, with the related concern of promoting the well-being of that industry. Often the public or consumer interest is viewed as subordinated, or even ignored, as the agency focuses on the needs and concerns of the industry that it is regulating.

In some cases — because of the unique expertise possessed by the members of the industry or its job enticements for regulators who leave government employment — the regulatory commission is alleged to have become a captive of the industry which it is supposed to regulate. At the least, this is a popularly held view of the development of the federal regulatory process. In addition to the ICC, other examples of this development which have been cited from time to time include the Civil Aeronautics Board, the Federal Communications Commission, the Federal Power Commission, and the Federal Maritime Commission.

imprimis (im-pri-mis) adv. In the first place. Middle English, from Latin *in primis*, among the first (things).

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## The New Model of Government Regulation

Although the traditional type of federal regulation of business surely continues, the new regulatory efforts established by the Congress in recent years follow, in the main, a fundamentally different pattern.

The new federal regulatory agencies are simultaneously broader in the scope of their jurisdiction than the ICC-CAB-FCC-FPC model, yet in important aspects far more restricted. This anomaly lies at the heart of the problem of relating their efforts to the national interest.

In the cases of the Environmental Protection Agency, the Equal Employment Opportunity Commission, the Consumer Product Safety Commission, the Federal Energy Administration, and the Occupational Safety and Health Administration, the regulatory agency is not limited to a single industry. In the case of each of these relative newcomers to the federal bureaucracy, its jurisdiction extends to the bulk of the private sector and at times to productive activities in the public sector itself. It is this far-ranging characteristic that makes it impractical for any single industry to dominate these regulatory activities in the manner of the traditional model. What specific industry is going to capture the EEOC or OSHA, or would have the incentive to do so?

Yet in comparison to the older agencies, the newer federal regulators in many important ways operate in a far narrower sphere. That is, they are not concerned with the totality of a company or industry, but only with the narrow segment of operations which falls under their jurisdiction. The ICC, for example, must pay attention to the basic mission of the trucking industry, to provide transportation services to the public, as part of its supervision of rates and entry into the trucking business. The EPA, on the other hand, is interested almost exclusively in the effect of trucking operations on the environment. This limitation prevents the agency from developing too close a concern with the overall well-being of any company or industry. Rather, it can result in a total lack of concern over the effects of its specific actions on a company or industry.

If there is any special interest that may come to dominate such an agency, it is the one that is preoccupied with its specific task — ecologists, unions, civil rights groups, and consumerists.

Thus, little if any attention may be given to the basic mission of the industry to provide goods and services to the public. Also ignored are crosscutting concerns or matters broader than the specific charter of the regulating agency, such as productivity, economic growth, employment, cost to the consumer, effects on overall living standards, and inflationary impacts. At times the process may seem to be epitomized by that proverbial dentist who sees his patient as merely two rows of teeth surrounded by a mass of miscellaneous material.

The result of the new approach to government regulation of business may be the reverse of the traditional situation. Rather than being dominated

by a given industry, the newer type of federal regulatory activity is far more likely to utilize the resources of various industries, or to ignore their needs, in order to further the specific objectives of the agency.

To begin with, we must recognize that it is difficult to criticize their basic mission. One has to possess the personality of Scrooge to quarrel with the intent of the new wave of federal regulation — safer working conditions, better products for the consumer, elimination of discrimination in employment, reduction of environmental pollution, dealing with the energy problem, and so forth.



## What's the Cost of Regulation?

But at what costs have regulatory programs tried to achieve their purposes? The costs of overregulation of business are felt by our citizens in many ways: higher taxes to pay for the regulators, higher prices of the products we buy as a result of the regulations, loss of productivity and jobs, a slower rate of introduction of new and better products, and less capital available for new undertakings. Let me cite some specifics.

Federal regulation adversely affects the prospects for economic growth and productivity by laying claim to a rising share of new capital formation. This is most evident in the environmental and safety areas. It is revealing to examine the flow of capital spending by American manufacturing companies just prior to the recent recession. In 1969, the total new investment in plant and equipment in the entire manufacturing sector of the American economy came to \$25 billion. The annual totals rose in the following years, to be sure. But when the effect of inflation is eliminated, it can be seen that four years later, in 1973, total capital spending by U.S. manufacturing companies was no higher. In "real terms," it was approximately \$26 billion both in 1969 and 1973.

That is not the end of the story, however. In 1973, a much larger proportion of capital outlays was devoted to meeting government regulatory requirements in the pollution and safety area — \$3 billion more, to be specific. Hence, although the economy and its needs had been growing substantially in those four years, the real annual investment in modernization and new capital actually had been declining. The situation was worsened by the accelerated rate



at which existing manufacturing facilities were being closed down because of the rapidly rising costs of meeting government regulations. Specifically, about 350 foundries in the United States have been closed down in the past four years because they could not meet requirements such as those imposed by the EPA and OSHA.

The direct cost of government regulation, a topic rarely studied, is substantial. The number and size of the agencies carrying out federal regulations are expanding rapidly. The administrative cost of this veritable army of enforcers is large and growing. The expenditures of the major federal regulatory agencies came to almost \$1.9 billion in the fiscal year 1974. A 48 percent increase is budgeted over the next two years, with the total federal costs of these regulatory activities rising to \$2.8 billion in fiscal 1976. The costs of government regulation are rising far more rapidly than the sales of the companies being regulated. Regulation literally is becoming one of the major growth industries in the country.

### The Hidden Costs

But this represents only the tip of the iceberg. It is the costs imposed on the private sector that are really huge, the added expenses of business firms which must comply with government directives, and which inevitably pass on these costs to their customers.

The public does not get a free or even low-cost lunch by imposing requirements on private industry. In large measure, the costs of government regulation show up in higher prices of the goods and services that consumers buy. These higher prices represent the hidden tax imposed by government regulation on the consumer. Moreover, to the extent that government-mandated requirements impose similar costs on all price categories of a given product (say, automobiles) this hidden tax will tend to be more regressive than the federal income tax. That is, the costs may be a higher burden on lower income groups than on higher income groups.

Purchasers of new cars produced in the United States in 1974 paid over \$3 billion extra for the equipment and modifications needed to meet federal requirements. Mandatory auto buzzers and harnesses (the widely detested "interlock" system) will rapidly fade into history due to recent congressional action, but not until after more than 40 percent of the owners of those expensive and annoying contraptions disconnected them or otherwise found ways of avoiding their use. Nevertheless, the phenomenon of government adding to the costs of private production is continuing.

Another cost of government controls is the growing paperwork burden imposed on business firms: the expensive and time-consuming process of submitting reports, making applications, filling out questionnaires, replying to orders and directives, and court appeals resulting from some of the regulatory rulings. As of June 30, 1974, there were 5,146 different types of approved government forms, excluding tax and banking forms. Individuals and business firms spend over 130 million man-hours a

year filling them out.

A small, 5000 watt radio station in New Hampshire reported that it spent over \$26 just to mail to the Federal Communications Commission its application for renewing its license. An Oregon company, operating three small television stations, reported that its license renewal application weighed 45 pounds.

At the other end of the spectrum, a large corporation, Exxon Company USA, is required to file more than 400 reports to 45 federal agencies including the Department of the Treasury, the Federal Power Commission, and the Bureau of Indian Affairs. Many agencies require the same data but in slightly different form. Exxon submits 50 reports relating to personnel, labor and wages to 14 different federal agencies. In total, Exxon USA devotes 112 man years annually to these reporting requirements at a cost of \$3.5 million.

Another hidden cost of federal regulation is a reduced rate of technological innovation. The longer that it takes for some change to be approved by a federal regulatory agency — a new product or a more efficient production process — the less likely that the change will be made. In any event, innovation will be delayed. A recent case is the new asthma drug beclomethasone dipropionate (I call it BD). Although this drug has been used successfully by millions of asthma patients in England, it still has not received approval of the U.S. Food and Drug Administration.

BD is described as a safe and effective replacement for the drugs which are now administered to chronic asthma patients, but without the adverse side effects of the drugs in use in the United States. Unlike BD, the steroids currently used in this country, such as prednisone, can stunt growth in children, worsen diabetes, increase weight through water retention, and cause bone softening. The delaying procedures of the FDA are preventing Americans from switching to the safer product, BD.

Professor Sam Peltzman of the University of Chicago estimates that the 1962 amendments to the Food and Drug Act are delaying the introduction of effective drugs by about four years, as well as leading to higher prices for drugs. As a result we are no longer the leaders in medical science. The United States was the 30th country to approve the anti-asthma drug metaporoterenol, the 32nd country to approve the anti-cancer drug adriamycin, the 51st country to approve the anti-tuberculosis drug rifampin, the 64th country to approve the anti-allergenic drug cromolyn, and the 106th country to approve the anti-bacterial drug co-trimoxazole.

The regulators really seem to have the private sector scared. Take a recent example, the report last summer by the National Cancer Institute that the solvent trichloroethylene, known as TCE, may be a possible cause of cancer. TCE at the time had been used in decaffeinated coffee. It seems that the government used a rather generous dose of the chemical on the test animals. It was the equivalent of a human being drinking 50 million cups of decaffeinated coffee every day for his entire lifetime.

What was the industry's reaction? To laugh at this example of governmental nonsense? Hardly. With the cyclamate episode still firmly in mind, one major producer merely changed to another chemical.

### When Is a Roof a Floor?

An expected result of the lack of attention to the costs of regulation is the opportunity for regulators to engage in many exercises in trivia and on occasion sheer nonsense. Consider the plight of the small businessman who tries to deal with the OSHA rules without paying for expensive outside assistance. These are the kinds of questions that he must face: what size to establish for toilet partitions? How big is a hole? (It depends on where it is.) When is a roof a floor? What colors to paint various parts of a building? How frequently are spittoons to be cleaned? The public's taxes actually support people



who are willing to establish and administer regulations dealing with these burning issues.

Let us start with a supposedly simple matter, the definition of an exit. The dictionary tells us that exit is "a passage or way out." For OSHA enforcers, defining exit is a challenge to their bureaucratic instincts and they are not found wanting. To OSHA, an exit is "that portion of a means of egress which is separated from all other spaces of the building or structure by construction or equipment as required in this subpart to provide a protected way of travel to the exit discharge."

Obviously, you have to find out what is "a means of egress" as well as an "exit discharge." Exit discharge is defined merely as "that portion of a means of egress between the termination of an exit and a public way." But OSHA defines a means of egress as "a continuous and unobstructed way of exit travel from any point in a building or structure to a public way and consists of three separate and distinct parts: the way of exit access, the exit, and the way of exit discharge. A means of egress comprises the vertical and horizontal ways of travel and shall include intervening room spaces, doorways, hallways, corridors, passageways, balconies, ramps, stairs, enclosures, exits, escalators, horizontal exits, courts, and yards."

Shades of Gertrude Stein, OSHA is saying that an exit is an exit. Unlike the dictionary, the agency is unable to provide a definition of exit which does not contain the word exit in it. And exit is a comparatively easy one. In the case of ladder, the reader literally

has to cope with three renditions of the same tedious set of definitions plus one trigonometric function.

### Adverse Effects on Employment

Government regulations often have strongly adverse effects on employment. This has been demonstrated in the minimum wage area where teenagers have increasingly been priced out of labor markets. The Center for the Study of American Business recently published a study which indicates that the 1966 increase in the statutory minimum wage resulted by 1972 in teenage employment in the United States being 320,000 lower than it otherwise would have been. As a result of that one increase in the compulsory minimum wage law, the youth unemployment rate in 1972 was 3.8 percentage points higher than otherwise would have been the case.

In the construction labor area — where unemployment rates are substantially above the national average — government regulation also acts to price some segments of the work force out of competitive labor markets. Under the Davis-Bacon legislation, the Secretary of Labor promulgates "prevailing" wages to be paid on federal and federally-supported construction projects. A variety of studies have shown that these federally-mandated wage rates are often above those that actually prevail in the labor market where the work is to be done.

### Conflicts Among Regulations

It is perhaps inevitable, but the proliferation of government controls has led to conflicts among controls and controllers. In some cases, the rules of a given agency work at cross purposes with each other. OSHA mandates back-up alarms on vehicles at construction sites. Yet simultaneously the agency requires employees to wear earplugs, to protect them against noise, making it extremely difficult to hear the alarms.

Another example of conflicting objectives within a single regulatory agency occurs in the EPA. The desulfurization of coal — which is an effort to reduce air pollution — requires a combination with lime. But in the process, large quantities of solid waste are generated, calcium sulfate. Disposing of calcium sulfate, in turn, creates water pollution problems.

More serious and more frequent are the contradictions between the rulings of two or more government agencies where the regulated have little recourse. The simple task of washing children's pajamas in New York exemplifies how two sets of laws can pit one worthy objective against another, in this case ecology versus safety.

In 1973, New York State banned the sale of detergents containing phosphates, in an effort to halt water pollution. Less than two months later, a federal regulation took effect requiring children's sleepwear to be flame-retardant. New York housewives now face a dilemma, because phosphates are the strongest protector of fire-retardancy. They hold soil and minerals in solution, preventing the formation of a mask on the fabric that would inactivate flame-resistance. What does a conscientious mother do in a phosphate-banned area to avoid



dressing her child in nightclothes that could burn up? Smuggle in the forbidden detergents? Commit an illegal act of laundry?

Each regulatory agency seems to be exclusively preoccupied with its own narrow interest, and is oblivious to the effects of its actions on the company, a whole industry, or even to society as a whole.

The controversy over restrooms furnishes another example of the conflict among different regulations. It also demonstrates that common sense is in short supply in the administration of government controls. The Labor Department, in carrying out its weighty responsibilities under the Occupational Safety and Health Act, has provided industry with detailed instructions concerning the size, shape, dimensions, and number of toilet seats. For well-known biological reasons, it also requires some type of lounge area to be adjacent to women's restrooms.

However, the Equal Employment Opportunity Commission entered this vital area of government-business relations. The commission at one point required that male toilet and lounge facilities, although separate, must be equal to those provided to women. Hence, either equivalent lounges must be built adjacent to the men's toilets or the women's lounges must be dismantled, OSHA and state laws to the contrary notwithstanding. To those who may insist that nature did not create men and women with exactly identical physical characteristics and needs, we can only reply that regulation, like justice, must be blind.

### **Uncontrolled Power of Government Regulators**

The instances of waste and foolishness on the part of government regulators pale into insignificance when compared to the arbitrary power that they can exert. A vivid example is provided by the case of Marlin Toy Products of Horicon, Wisconsin.

The firm's two main products, Flutter Ball and Birdie Ball, were plastic toys for children, identical except that one contained a butterfly and the other a bird. The toys originally held plastic pellets that rattled. This led the Food and Drug Administration in 1972 to place the products on its ban list because it was worried that if the toys cracked the pellets could be swallowed by a child. The company recalled the toys and redesigned its product line to eliminate the pellets and thus be removed from the ban list.

The newly-formed Consumer Product Safety Commission in 1973 assumed responsibility in this area. Because of an "editorial error," it put the Marlin products on its new ban list, although there was no longer any reason to ban them. Apparently the commission incorporated an out-of-date FDA list. The error was called to the commission's attention, but it replied that it was not about to recall 250,000 lists "just to take one or two toys off."

Marlin Toy Products was forced out of the toy business and had to lay off 75 percent of its employees due to the federal error. It is ironic to note that the commission specializes in ordering companies to re-

call their products if any defective ones have been produced, but refuses to recall its own product when there is a defect in every single one.

Many liberals are outraged by the arbitrary "no-knock" powers of federal investigative agencies, yet they readily ignore the unchallenged no-knock power used by federal agencies in their regulation of private business. The Supreme Court has ruled that air pollution inspectors do not need search warrants to enter the property of suspected polluters as long as they do not enter areas closed to the public. The unannounced inspections, which were conducted without warrants, were held not to be in violation of constitutional protections against unreasonable search and seizure.

The inspectors of the Labor Department's Occupational Safety and Health Administration (OSHA) can go further. They have no-knock power to enter the premises of virtually any business in the United States, without a warrant or even prior announcement, to inspect for health and safety violations. Jail terms are provided in the OSHA law for anyone tipping off a "raid."

The awesome power exercised by government regulators often goes unappreciated by the public as well as by the regulators themselves. The case of the ban on spray adhesives is one that is worthy of some attention. On the surface, it appears to have been at most only a matter of excessive caution on the part of the Consumer Product Safety Commission.

On August 20, 1973, the commission banned certain brands of aerosol spray adhesives as an imminent hazard. Its decision was based primarily on the preliminary findings of one academic researcher who claimed that they could cause birth defects. After more careful research failed to corroborate the initial report, the commission lifted the ban on March 1, 1974. Why do I mention this case? Depriving consumers of spray adhesives for less than seven months does not seem to be too harsh in view of the desire to avoid serious threats to people's health.

But there is more to the story. It seems that a number of pregnant women who had used the spray adhesives reacted to the news of the commission's initial decision by undergoing abortions. They decided not to carry through their pregnancies for fear of producing babies with birth defects. The sadness of this case is hardly reduced by the fact that everyone involved was trying to promote the public health and safety.

### **Conclusion**

This is not a general attack on all forms of government regulation. Unless you are an anarchist, you believe that government should set rules for society. But there are serious questions as to what rules to set, how detailed they should be, and how they are to be carried out. Let me now sketch out the positive approach that I favor.

Numerous government activities often unwittingly produce unwanted side-effects, which occur because government policymakers often tend to ignore the effects of government programs on productivity,

capital formation, innovation, and inflation. For example, government imposition of socially desirable requirements on business through the regulatory process appears to be an inexpensive way of achieving national objectives. It costs the government little and is no significant burden on the taxpayer. But, the public does not escape paying the cost. Every time that OSHA imposes a more costly, albeit safer, method of production, the cost of the resultant product will tend to rise. Similarly, each time that the Consumer Product Safety Commission sets a standard which is more costly to attain, some product costs will tend to rise.

The monetary authorities could offset the inflationary effects of regulation by attempting to maintain a lower rate of monetary growth. In practice, however, public policy makers tend to prefer the higher rate of inflation to the additional monetary restraint and the resulting decreases in employment and real output.

This problem requires a new way of looking at the microeconomic effects of government programs. A parallel can be drawn to macroeconomic policymaking, where important and at times conflicting objectives are recognized. Attempts at reconciliation or trade-off are made among economic growth, employment, income distribution, and price stability.

At the programmatic or microeconomic level, it is also necessary to reconcile the goals of specific government programs with other important national objectives, which are not now in practice the concern of many of those agencies. Healthy working conditions are an important national objective — but surely not the only one.

Professor F. A. Hayek has presented the theoretical basis for this approach:

... a free market system does not exclude on principle ... all regulations governing the techniques of production ... They will normally raise the cost of production, or what amounts to the same thing, reduce overall productivity. But if this effect on cost is fully taken into account and it is still thought worthwhile to incur the cost to achieve a given end, there is little more to be said about it. The appropriateness of such measures must be judged by comparing the over-all costs with the gain; it cannot be conclusively determined by appeal to a general principle.

Because of the very substantial costs and other adverse side-effects that they give rise to, society should take a new and hard look at the existing array of government controls over business. A substantial effort should be made to change or eliminate those controls that generate excessive costs. Rather than blithely continuing to proliferate government controls over business, alternative means of achieving important national objectives should be explored and developed, solutions that expand rather than reduce the role of the market.

A good beginning might be based, oddly enough, on the environmental regulations. In general, the society is supposed to examine the impact on the environment of various actions that it takes. Would it not also be appropriate to require each environmental agency to assess the impacts of its action on the society as a whole and particularly on the economy? I urge the same balanced attitude for the other new regulatory programs, including product safety, job health, equal employment, energy, et al.

Merely legislating the performance of some economic analysis by an unsympathetic regulator would only delay the regulatory process and make it more costly. But limiting government regulation to those instances where the total benefits to society exceed the cost would be a major departure. It could significantly slow down if not reverse the current rising trend of federal regulation of business. Those who question our ability to make such estimates should be required to justify powerful governmental actions in the absence of adequate knowledge of their effects.

In a fundamental sense, it is a way of thinking that needs to be developed in public policymaking, rather than a new concentration on statistical expertise. Regulation is a powerful tool. It must be used carefully and with full regard for the often unintentional side effects.

In a sense, I am proposing that public policy take the best from both the old and the new models of government regulation of business. As in most things in life, the sensible questions are not matters of either/or, but rather of more or less and how. To an economist, government regulation should be carried to the point where the incremental benefits equal the incremental costs — and no further. Overregulation — which can be defined as situations where the costs exceed the benefits — should be avoided. But if policy makers tend to ignore or downplay the costs, we are bound to operate in the zone of overregulation, which is where we are today.

Perhaps even more fundamental than developing technical benefit/cost analyses is getting the public to grasp the notion that government regulation is a powerful medicine. It needs to be taken very carefully, in limited doses, and with full regard for all the adverse side-effects. We must avoid unwittingly overdosing the patient. Better yet, we must quit following the advice of well-meaning individuals who do not understand the consequences of their proposals.

I am not proposing to eliminate all government regulation of business. I am urging balance and moderation, so that business can both help to achieve the nation's social goals and can still fulfill the basic economic function of more efficient production and distribution of better goods and services. To restore common sense to government is a major challenge to economic education of the public.